

REPORT OF EXAMINATION
OF THE
SPRINGFIELD INSURANCE COMPANY

AS OF
DECEMBER 31, 2009

Participating State
and Zone:

California

Filed January 20, 2011

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Los Angeles, California
November 24, 2010

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Christina Urias
Secretary, Zone IV-Western
Director of Insurance
Arizona Department of Insurance
Phoenix, Arizona

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of the

SPRINGFIELD INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 874 South Village Oaks Drive, Covina, California 91724.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2006. This examination covers the period from January 1, 2007 through December 31, 2009. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2009, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; accounts and records; and sales and advertising.

COMPANY HISTORY

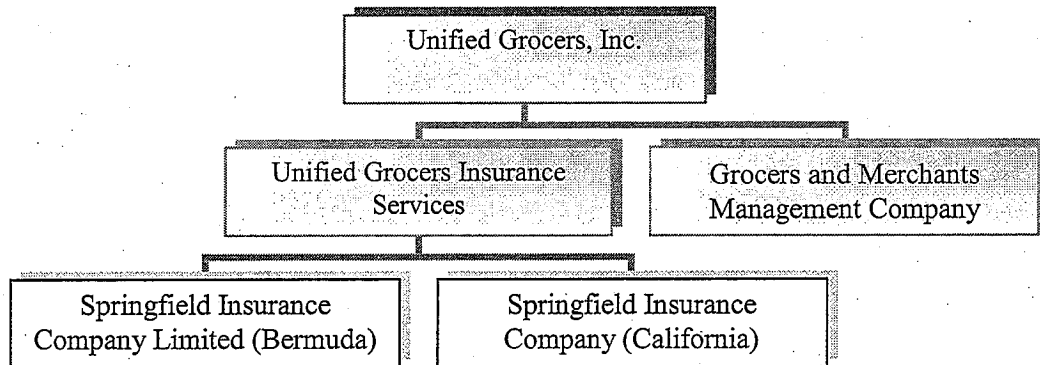
The Company was incorporated in the State of California on May 9, 1988 and commenced transacting property and casualty business on October 1, 1989. Effective February 20, 2008, the Company's ultimate parent, Unified Western Grocers, Inc., changed its corporate name to Unified Grocers, Inc. and effective May 9, 2008, the Company's immediate parent, Grocers and Merchants Insurance Service, Inc., changed its name to Unified Grocers Insurance Services.

On August 18, 2008, the Company increased the par value of its common stock from \$520 to \$600 per share. The total authorized common stock shares remained unchanged at 50,000 shares, and the issued and outstanding common stock shares remained unchanged at 5,000 shares. In order to capitalize the increase in the par value per share amount to \$600, the Company transferred \$400,000 from its gross paid-in and contributed surplus account to its capital account. This resulted in its common capital stock account increasing from \$2.6 million to a total of \$3 million; and conversely, its gross paid-in and contributed surplus account decreasing from \$8.9 million to \$8.5 million. This transaction occurred in order to comply with the State of Washington's statutory minimum surplus requirements as part of the Company's application for a Certificate of Authority in that state. The Company notified the California Department of Insurance (CDI) regarding this transaction, and received an acknowledgement for filing from the CDI on December 19, 2008. In reviewing the transaction, it was noted that the Company failed to amend its Articles of Incorporation to reflect the change in its common stock par value. As a result of this finding, the Company amended its Articles of Incorporation to reflect the change in its common stock par value on October 27, 2010.

MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of an insurance agency, Unified Grocers Insurance Services (UGIS), which in turn, is wholly-owned by the organization's ultimate parent, Unified Grocers, Inc. (Unified). Unified is a non-insurance member-owned cooperative organization, primarily engaged in the distribution of grocery products to its member retail grocers throughout the western United States.

The following abridged organizational chart depicts the Company's relationship within the holding company system: (all ownership is 100%)



Management of the Company is vested in an eight-member board of directors elected annually. A listing of the members of the board of directors and principal officers serving on December 31, 2009 follows:

Directors

Name and Residence

Principal Business Affiliation

Andrew J. Barile
Rancho Santa Fe, California

President and Chief Executive Officer
Andrew Barile Consulting Corporation, Inc.

Mark H. Kidd
Acampo, California

President
Mar-Val Food Stores, Inc.

Darioush Khaledi
Palos Verdes Estates, California

Chairman and Chief Executive Officer
K.V. Mart Company

John Najjar
Cardiff, California

President
Cardiff Seaside Market, Inc.

Peter J. O'Neal (*)
Vancouver, Washington

President
White Salmon Foods, Inc & Estacada Foods, Inc.

John L. Sullivan Jr.
San Anselmo, California

Chairman and Chief Executive Officer
Majestic Insurance Company

Michael S. Trask
Granite, Washington

President
Stanlar Foods, Inc.

Richard L. Wright(**)
Eugene, Oregon

Chairman of the Board
Market of Choice, Inc.

(*) Resigned as Board Member, effective April 2010

(**) Resigned as Board Member, effective April 2010

Mr. Richard E. Goodspeed became a Board Member effective February 2010

Principal Officers

Name

Title

Joseph A. Ney
Jeffrey D. Moore
Randall G. Scoville
Richard J. Martin
Robert M. Ling, Jr.
Christine B. Neal
Paula G. Spalding

President
Executive Director, Risk Management
Chief Accounting Officer
Chief Financial Officer
Secretary
Treasurer
Vice President Underwriting

NameTitle

Jeffrey D. Haynes

Vice President, Workers Compensation Claims

Management Agreements

Management Service Agreement: Effective March 3, 1995, the Company entered into a Management Service Agreement with its parent, Unified Grocers Insurance Services (UGIS), and its affiliate, Grocers and Merchants Management Company (GMMC). Under the terms of the agreement, UGIS and GMMC provided the Company with services including management, accounting, underwriting, claims, data processing, premium collection, commission accounting, and personnel services on an actual cost basis. During the 2007, 2008, and 2009 years, the Company compensated UGIS and GMMC \$5.5 million, \$5.7 million, and \$5.5 million, respectively, under the terms of the Management Service Agreement. The California Department of Insurance (CDI) approved this agreement on February 28, 1995.

During the current examination period, the Company renewed the Management Service Agreement, but failed to report the transaction in accordance with California Insurance Code (CIC) Section 1215.4(b) (Form B filings). To correct the reporting deficiency, on April 20, 2010, subsequent to the examination date, but prior to the commencement of the statutory examination, the Company terminated its previous aforementioned Management Service Agreement, and entered into a new Service Agreement with its parent, UGIS. Under the terms of the agreement, UGIS provides the Company with the following services: financial reporting, tax compliance, treasury services, budget and cost accounting, human resources, payroll, legal, information technology, marketing, and facilities. The services are provided on an actual cost basis. The CDI approved the agreement on April 9, 2010.

Brokerage Agreement: Under the terms of a Brokerage Agreement, effective date of March 3, 1995, the parent company, UGIS, produced and serviced business for the Company and received commissions in return, with commission rates ranging from 5% to 15%. During the 2007, 2008, and 2009 years, the Company paid UGIS commissions of \$1.9 million, \$1.8 million, and \$1.7 million,

respectively, under the terms of the agreement. The CDI approved the agreement on February 28, 1995.

During the current examination period, the Company amended and renewed the Brokerage Agreement, but failed to report these transactions within their Form B filings and failed to obtain prior approval from the CDI. To correct these reporting deficiencies, on April 10, 2010, subsequent to the examination date, but prior to the commencement of the statutory examination, the Company terminated its previous aforementioned Brokerage Agreement, and entered into a new Agency Agreement with UGIS. Under the terms of the Agency Agreement, UGIS continues to produce and service business for the Company in exchange for commissions. The new agreement updates the commission rates for the states in which the Company's business is produced, with commission rates ranging from 5% to 15% on the business produced. The CDI approved the agreement on April 9, 2010.

Services Agreement: Effective December 19, 2006, the Company entered into a Services Agreement with its ultimate parent, Unified Grocers, Inc. (Unified). The CDI approved this agreement on December 18, 2006. Under the terms of the agreement, Unified provided the Company with administrative support services, such as financial reporting, tax compliance, treasury services, budget and cost accounting, human resources, actuarial services, and office services. The provisions of the agreement required the Company to reimburse Unified for the actual cost of the services provided. It was ascertained that the Company did not reimburse Unified for any of the services provided in accordance with the terms of the agreement. In lieu of reimbursing Unified, the Company's parent, UGIS, reimbursed Unified for the services provided by Unified to the Company. On October 23, 2008, the Company replaced the aforementioned agreement with a new Services Agreement. The parties, terms, and conditions remained the same under the new agreement and the new agreement was executed to reflect the change in the ultimate parent's name from Unified Western Grocers, Inc., to Unified Grocers, Inc. The Company submitted the new Services agreement to the CDI for approval however this agreement was subsequently withdrawn and terminated with the submission of a new Services Agreement with UGIS, approved by the CDI on April 9, 2010. The Company now provides direct reimbursement for the services provided by UGIS.

The Company did not report the December 19, 2006 and October 23, 2008 agreements within its Form B filings. It is recommended that the Company amend its 2010 Form B - Annual Registration Statement filing to report and disclose the following omitted related party transactions in accordance with CIC Section 1215.4(b), the Insurance Holding Company System Regulatory Act:

- The Services Agreements with Unified, dated December 19, 2006 and October 23, 2008;
- The omitted historical information related to the terminated Management Service Agreement and Broker Agreement, as previously noted above. In addition, during the past seven years, changes to these agreements were not reported, such as the dates the agreements were renegotiated, renewed, or amended. These changes should be included within the Form B filing.

Lease Agreement: On January 22, 2007, the Company and its parent, UGIS, entered into a Purchase and Sale Agreement (Sale Agreement) wherein UGIS purchased the Company's home office building for \$3.2 million. Simultaneous with the Sale Agreement, the Company and UGIS entered into a Commercial Lease Agreement (Lease Agreement) wherein the Company leases its home office building from UGIS. The Lease Agreement, effective February 1, 2007, is for a sixty month term. The CDI approved the Sale and Lease Agreements on May 7, 2007 pursuant to CIC Sections 1215.5(b)(1) and 1215.5(b)(4). The Sale and Lease Agreements were accounted for pursuant to the Statements of Statutory Accounting Principles (SSAP) Number 22, Paragraph 13. During the 2007, 2008, and 2009 years, the Company paid UGIS lease amounts of \$138,854, \$231,000, and \$231,000, respectively, under the terms of the lease agreement.

Tax Allocation Agreement: Under the terms of a consolidated Tax Allocation Agreement, the Company, its affiliates, and its ultimate parent, Unified, file a consolidated federal income tax return. The consolidated federal income tax liability is allocated between the companies in the ratio that each company's separate tax return liability bears to the total consolidated federal income tax liability. This agreement was entered into and approved by the CDI on April 14, 1998. The Company paid the following taxes during the examination period:

| <u>Year</u> | <u>Amount</u> |
|-------------|---------------|
| 2007 | \$ 2,244,527 |
| 2008 | 943,988 |

| | |
|-------|---------------------|
| 2009 | <u>2,034,453</u> |
| Total | <u>\$ 5,222,968</u> |

TERRITORY AND PLAN OF OPERATION

As of December 31, 2009, the Company was licensed to transact multiple lines of property and casualty insurance in the following states:

| | | |
|------------|------------|------------|
| Arizona | Nevada | Texas |
| California | New Mexico | Utah |
| Idaho | Oregon | Washington |
| Montana | | |

Subsequent to the examination date, the Company received Certificates of Authority for the States of Colorado and Wyoming.

During the examination period, the principal line of business written was workers' compensation insurance. In 2009, the Company wrote \$21.8 million of direct premiums, 90.4% of which was written in California.

The Company provides workers' compensation, general liability and automobile liability coverage to its ultimate parent, Unified Grocers, Inc. (Unified), and its subsidiaries. In addition, workers' compensation, commercial automobile, general liability, and commercial package coverage is offered to Unified's member companies that are wholesalers or retailers of grocery goods. In addition to the previously mentioned lines of business, in 2008 the Company obtained a license to transact marine, plate glass, boiler, and machinery insurance products in California. The new lines of insurance were added to its existing commercial multiple peril package to provide a more comprehensive insurance program.

Effective January 1, 2007, the Company's corporate workers' compensation program was converted from a large deductible policy to a fully insured policy. As a result, the Company's earned premiums for this business increased approximately \$7.2 million in 2007.

The Company's parent, Unified Grocers Insurance Services, Inc. (UGIS), produces the majority of its business, and also operates as an insurance agency/broker for Unified and its member companies for insurance coverage not offered by the Company.

LOSS EXPERIENCE

A review of the Company's loss experience data during the examination period, disclosed a trend of net underwriting losses as follows:

| Year | Net Underwriting (Loss) |
|---------|-------------------------------|
| 2007 | \$ (561,566) |
| 2008 | (303,415) |
| 2009 | (1,884,468) |
| 2010(*) | (2,202,556) |

(*) Through September 30, 2010

Since 2007, underwriting performance has been affected by an increasingly competitive market resulting in the shift of the Company's portfolio to first dollar policies, which have produced higher loss ratios than the high deductible policies previously written. In addition, significant declines in worker compensation base rates in California have also negatively impacted underwriting performance. To address the net underwriting losses, the Company is closely monitoring the renewal of its policyholder accounts, and subsequent to the examination, in September 2010, and during the renewal of its reinsurance program, it reduced its retention for all lines of business to \$250,000.

REINSURANCE

Assumed

The Company does not assume reinsurance.

Ceded

The following is a summary of the Company's principal reinsurance agreements in force as of December 31, 2009:

| Type of Contract and Lines of Coverage | Reinsurer(s) Name | Company's Retention | Reinsurer's Maximum Limits |
|--|--|---------------------|--|
| Excess of Loss | | | |
| Workers' Compensation | Old Republic Insurance Company | \$2 million | \$58 million excess of \$2 million |
| Property (Facultative) | | | |
| Commercial Multiple Peril | General Reinsurance Company | \$1 million | \$4 million excess of \$1 million |
| Property | | | |
| Equipment Breakdown Coverage | Hartford Steam Boiler Inspection and Insurance Company | None | \$25 million per accident, per policy; \$25,000 spoilage coverage per accident |

As of the examination date, and under the terms of its reinsurance agreements, the Company reported total reinsurance recoverables of \$14.5 million or 51% of reported surplus.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2009

Underwriting and Investment Exhibit for the Year Ended December 31, 2009

Reconciliation of Surplus as Regards Policyholders
from December 31, 2006 through December 31, 2009

Statement of Financial Condition
as of December 31, 2009

| <u>Assets</u> | Ledger and Nonledger Assets | Assets Not Admitted | Net Admitted Assets | Notes |
|---|-----------------------------------|------------------------|------------------------|-------|
| Bonds | \$ 68,523,332 | \$ | \$ 68,523,332 | |
| Cash and short-term investments | 3,844,068 | | 3,844,068 | |
| Investment income due and accrued | 698,647 | | 698,647 | |
| Uncollected premiums and agents' balances in course of collection | 3,204,459 | | 3,204,459 | |
| Deferred premiums, agents' balances and installments booked but deferred and not yet due | 3,436,793 | 12,520 | 3,424,273 | |
| Accrued retrospective premiums | 34,469 | 3,447 | 31,022 | |
| Reinsurance: | | | | |
| Amounts recoverable from reinsurers | 370,339 | | 370,339 | |
| Other amounts receivable under reinsurance contracts | 205,804 | | 205,804 | |
| Current federal and foreign income tax recoverable | 1,129,658 | 1,129,658 | 0 | |
| Net deferred tax asset | 2,123,713 | 42,227 | 2,081,486 | |
| Aggregate write-ins for other than invested assets | <u>1,335,487</u> | <u>1,083</u> | <u>1,334,404</u> | |
| Total assets | <u>\$ 84,906,769</u> | <u>\$ 1,188,935</u> | <u>\$ 83,717,834</u> | |
| <u>Liabilities, Surplus and Other Funds</u> | | | | |
| Losses | | | \$ 36,410,636 | (1) |
| Loss adjustment expenses | | | 8,456,530 | (1) |
| Other expenses | | | 41,298 | |
| Unearned premiums | | | 4,940,232 | |
| Amounts withheld or retained by company for account of others | | | 5,250,456 | |
| Payable to parent, subsidiaries and affiliates | | | 49,042 | |
| Aggregate write-ins for liabilities | | | <u>142,791</u> | |
| Total liabilities | | | 55,290,985 | |
| Common capital stock | | \$ 3,000,000 | | |
| Gross paid-in and contributed surplus | | 8,500,000 | | |
| Unassigned funds (surplus) | | <u>16,926,849</u> | | |
| Surplus as regards policyholders | | | <u>28,426,849</u> | |
| Total liabilities, surplus and other funds | | | <u>\$ 83,717,834</u> | |

Underwriting and Investment Exhibit
for the Year Ended December 31, 2009

Statement of Income

Underwriting Income

| | | |
|--------------------------------------|------------------|-------------------|
| Premiums earned | | \$ 21,068,181 |
| Deductions: | | |
| Losses incurred | \$ 14,123,002 | |
| Loss expense incurred | 3,651,926 | |
| Other underwriting expenses incurred | <u>5,177,721</u> | |
| Total underwriting deductions | | <u>22,952,649</u> |
| Net underwriting loss | | (1,884,468) |

Investment Income

| | | |
|--|----------------|---------------------|
| Net investment income earned | \$ 3,327,451 | |
| Net realized capital gains | <u>536,437</u> | |
| Net investment gain | | <u>3,863,888</u> |
| Net income before federal and foreign income taxes | | 1,979,420 |
| Federal and foreign income taxes incurred | | <u>618,485</u> |
| Net income | | <u>\$ 1,360,935</u> |

Capital and Surplus Account

| | | |
|---|------------------|----------------------|
| Surplus as regards policyholders, December 31, 2008 | | \$ 27,361,991 |
| Net income | \$ 1,360,935 | |
| Change in net deferred income tax | 127,871 | |
| Change in nonadmitted assets | (302,507) | |
| Change in provision for reinsurance | 2,963 | |
| Aggregate write-ins for losses in surplus | <u>(124,404)</u> | |
| Change in surplus as regards policyholders | | <u>1,064,858</u> |
| Surplus as regards policyholders, December 31, 2009 | | <u>\$ 28,426,849</u> |

Reconciliation of Surplus as Regards Policyholders
from December 31, 2006 through December 31, 2009

Surplus as regards policyholders, December 31, 2006,
per Examination

\$ 21,953,154

| | <u>Gain in Surplus</u> | <u>Loss in Surplus</u> |
|---|----------------------------|----------------------------|
| Net income | \$ 5,403,254 | \$ |
| Change in net deferred income taxes | 1,361,251 | |
| Change in nonadmitted assets | 553,742 | |
| Capital Changes: Transferred from surplus | 400,000 | |
| Surplus adjustments: Transferred to capital | | 400,000 |
| Aggregate write-ins for losses in surplus | | <u>844,552</u> |
| Totals | <u>\$ 7,718,247</u> | <u>\$ 1,244,552</u> |

Net increase in surplus as regards policyholders

6,473,695

Surplus as regards policyholders, December 31, 2009,
per Examination

\$ 28,426,849

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses and Loss Adjustment Expenses

The Company's loss and loss adjustment expense reserves were reviewed by a Casualty Actuary from the California Department of Insurance. Based on the analysis, the loss and loss adjustment expense reserves as of December 31, 2009 were determined to be reasonably stated and have been accepted for purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management Agreements (Page 5): It is recommended that the Company amend its 2010 Form B - Annual Registration Statement filing to report and disclose omitted related party transactions in accordance with the Insurance Holding Company Regulatory Act, CIC Section 1215.4(b).

Previous Report of Examination

Accounts and Records (Page 9): It was recommended that the Company provide all supporting financial statement documentation to the examination team in a timely manner to avoid examination delays. The Company complied with this recommendation during the current examination.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/

Edward W. Aros, CFE
Examiner-In-Charge
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California